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July 15, 1996

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JUL 15 1996

Federal Communications Commission
Office of Secretary

BY HAND DELIVERY

Mr. William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996

Dear Mr. Caton:

Please find enclosed for filing the original and fifteen copies of the Reply Comments of the RBOC Payphone Coalition. I also include an electronic version of the Reply Comments, as requested by the Commission.

Please date-stamp and return to the messenger the extra copy of the Reply Comments.

Sincerely,

Michael Kellogg

Michael K. Kellogg

Enclosures

No. of Copies rec'd 0+11

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE
RBOC PAYPHONE COALITION

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July 15, 1996

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EXECUTIVE SUMMARY

Despite their extensive numbers, the comments filed in this proceeding fall into five basic categories: those from independent PSPs; from RBOC/LEC PSPs; from carriers/OSPs; from location providers; and from state regulators. The positions taken are fairly uniform within these groups and, with few exceptions, predictably reflect their own narrow interests. Thus, the independent PSPs, while wishing to promote per-call compensation generally, are eager to enhance their own competitive position by saddling LEC PSPs with special obligations, costs and other disadvantages that would not apply to their own operations. The IXCs seek to minimize the compensation they must pay by preventing RBOC PSPs from participating in carrier selection. Location providers are concerned about preserving their commissions (whether competitively based or not). And state regulators are concerned with preserving their authority over what has heretofore been viewed as a matter of largely local concern.

Rarely in the heap of comments is there to be found any vision for where the industry is headed; most commenters simply stake out the positions they think will prove most beneficial to themselves. This is the regulatory process at its worst, where special interest pleadings substitute for competition as a way of gaining a marketplace advantage.

In sorting through these competing interests, the Commission cannot simply count noses and look for compromise positions. That approach would play into the hands of interest group posturing. In any event, such compromises are rarely satisfactory and usually collapse or are pulled apart on appeal because they have no solid statutory foundation. Instead, the Commission should adhere to the goals articulated by Congress in Section 276: "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public." The Commission must fashion each of its decisions to serve these overarching goals and should attempt to articulate and give life to a vision for where the payphone industry is headed.

The long-term interests of the public are best served by moving towards a fully competitive payphone industry in which the give and take of supply and demand can substitute for the give and take of the regulatory process. Competition among payphone providers will promote the widespread deployment of payphone services, ensure efficient, affordable service, create high-quality jobs, and ensure economic growth for the benefit of the general public. Wherever possible, therefore, the Commission should look for market and market-based solutions to the questions posed in the NPRM. Such solutions are possible throughout this industry

As demonstrated in Iowa, deregulation works even on issues such as the local coin rate and public interest phones. A market-based approach can work on an array of other issues facing the Commission and, in the process, make complex and endless regulatory battles unnecessary. Thus, per-call compensation should be based, not on a regulator's determination of costs, but on the market's determination of value. The Commission can readily derive a market-based proxy for per-call compensation based on the negotiated commissions paid by IXCs to independent PSPs on 0+ calls. Even this per-call rate, however, should not be fixed in stone. It should act as a default rate, to be replaced by marketplace negotiations wherever the market can work. Letting the market work freely is also the key reason to permit RBOC PSPs to negotiate with location providers over their choice of IXC, just as other PSPs do today. Similarly, non-RBOC PSPs should be involved in the choice of the intraLATA carrier. Such regulatory parity is critical to effective marketplace competition.

In short, competition, not regulation, should be the Commission's lodestar on every issue that it faces. If it follows that lodestar, it cannot go wrong. Consumers and the payphone industry generally will be the beneficiaries. Only the special interest pleaders will be at risk of losing unless they make their operations responsive to a competitive market.

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REPLY COMMENTS OF THE RBOC PAYPHONE COALITION

In these reply comments, the Coalition will not repeat points made in its initial filing, except where necessary to defend or amplify them Where there has been no substantial disagreement expressed, the Coalition simply stands on its prior statements.

I. THE COMMISSION'S PER-CALL COMPENSATION PLAN SHOULD PROVIDE COMPREHENSIVE AND FAIR MARKET-BASED COMPENSATION

A. The Commission Must Ensure that PSPs are Fairly Compensated for Each and Every Completed Intrastate and Interstate Call Made Using Their Payphones

Although Section 276(b)(1)(A) of the Telecommunications Act of 1996 requires the Commission to "establish a per-call compensation plan to ensure that all [PSPs] are fairly compensated for each and every completed intrastate and interstate call using their payphone," the Commission is not required by statute to dictate the level of compensation for every call. See Comments of Peoples Tel. Co. at 12 ("Peoples"). Where the market functions, the market will provide a fair (indeed, the fairest) price without Commission intervention. See NPRM ¶ 16. Thus, the Commission's original suggestion that it need not determine compensation for independent PSPs on 0+ calls is correct. These PSPs have had a full and fair opportunity to negotiate their compensation in the marketplace.

Sprint, however, wrongly suggests that all calls handled by presubscribed 0+ carriers (including dial-around calls, subscriber toll free calls and debit card calls -- not just 0+ calls) should be excluded from the per-call compensation scheme. Comments of Sprint at 6. That suggestion makes no sense. The amount of dial-around and 800 traffic a carrier receives has nothing to do with whether the payphone is or is not presubscribed to that carrier. To the contrary, the PSP has no power to block those calls so as to trigger a market-based transaction, and the IXC has no incentive to compensate for them since it otherwise gets them for free.

Similarly, the market cannot provide compensation where RBOC PSPs have been forbidden to negotiate with location providers, who are now locked into long-term contracts with IXCs. As a result, the Commission must intervene to establish per-call compensation on these calls.[1] To do otherwise would be inconsistent with the statutory mandate that there be compensation for each and every completed call.[2]

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[1]MCI argues that all calls to presubscribed carriers should be exempted because the "payphone owner can require fair compensation for all calls to the presubscribed carrier." Comments of MCI at 3. At the same time, however, MCI seeks to deny RBOCs that ability by opposing their right to participate in the selection of the presubscribed carrier. Id. at 18-19. Nor does MCI address the fact that RBOC PSPs cannot negotiate where the IXC has locked-up an RBOC payphone with a long-term contract. MCI's related rationale for excluding inmate-only phones from per-call compensation -- MCI argues that providers of inmate-only phones are guaranteed compensation through 0+ contracts because almost all calls on those phones are 0+ calls -- is identically defective. First, RBOCs can obtain compensation on 0+ interLATA calls only if they are permitted to negotiate with prisons over the choice of the IXC. Second, the Commission must still account for the effects of long-term contracts.

[2]We agree with Frontier that LECs should pay per-call compensation on the intraLATA toll calls they carry. Comments of Frontier Tel. Co. at 20. Just as with interLATA calls, the market should set the rate if negotiations for commissions are possible, such as where PSPs can choose their intraLATA carrier using smart phones or intraLATA presubscription. A default rate based on market proxies need only be established where negotiations cannot function.

Intellicall is wrong in suggesting that the Commission should exempt calls of less than 1 minute. See Comments of Intellicall at 34. A short call is still a call and cannot be exempted from the statutory mandate. The same is true of debit card calls, and calls made to small carriers. See Comments of the Telecommunications Resellers Ass'n at 16 ("TRA").[3]

MCI is equally wrong when it argues that there should be no compensation on calls made from semi-public phones. According to MCI, "LECs charge premise[s] owners for semi-public [phones]" and thus "already receive[] 'fair' compensation for calls from th[o]se phones." MCI at 3. Semi-public payphones, however, are included in the statutory definition of payphone service (section 276(d)), and there is no statutory basis to distinguish between them and other payphones. The financial arrangements between the location provider and the PSP will not in any way alter the obligation of carriers to pay per-call compensation for calls from these payphones. Because the carrier benefits when it receives calls from those phones, it should be required to pay. Moreover, there is no tracking mechanism for distinguishing one type of payphone from another. Semi-public phones are not a unique class of equipment and cannot be separately identified based on their ANIs; they are just a unique pricing arrangement with the location provider. Exempting semi-public phones from per-call compensation thus not only

[3]TRA suggests that debit card calls be exempted for some period of time because it is a low margin business serving low income callers. Alternatively, TRA asks that cards currently in circulation be somehow "grandfathered." TRA at 16. Neither proposal has merit. The fact that debit card providers have grown dependent upon the free ride given to 800 access code dialing from payphones in the past does nothing to counter the congressional command that the free ride not continue into the future. Debit card providers have ample time to adjust their operations and pricing, and will benefit from the removal of payphone subsidies from the common carrier line charge in any event.

would wrongly benefit carriers at the expense of PSPs and location providers, but would create an administrative nightmare as well.[4]

MCI asks the Commission to clarify that a call is "completed" when transmitted to the called party (i.e., there is a billable call), and that it is insufficient simply to reach an intervening carrier's network. MCI at 2: see also Comments of Cable & Wireless, Inc. at i ("CWI"). The Coalition agrees, but the inevitable corollary is that every call connected to a called party (including a pager or a voice mail system) is a completed call, even if it is the result of regenerating the dial-tone. See Sprint at 13 n.8 ("when multiple calls are made on a single connection (a feature offered by Sprint's FONcard by pressing the # key to reoriginate a second or third call on the same connection to its calling card platform), each such call should be subject to the set use fee").[5]

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[4]MCI's suggestion that compensation is not practical on international calls billed to non-U.S. carrier customers (supposedly because the Commission would have no jurisdiction to require the foreign carrier to bill and collect PSP compensation) is silly. MCI at 3; see also Sprint at 8. U.S. IXCs participate in the handling of every U.S.-originating international call, and they are well compensated through the international settlements process as a result. Any costs associated with per-call compensation on payphone-originated international calls can be taken into account when negotiating settlement rates. Recognizing this, AT&T supports requiring per-call compensation on international calls.

[5]Excel argues that "[c]alls where answer supervision is unavailable should . . . fall outside [the per-call] compensation mechanism [because] there is no way for the IXC to ascertain whether the call was ever completed." Comments of Excel at 6. Answer supervision, however, is available on all calls placed over the public switched network. Indeed, answer supervision is a necessity because it is the trunk reversal that indicates that the call has been answered and initiates billing. Since Excel and other OSPs are able to bill for their calls, they must already have the ability to determine if a call is completed

Other issues will arise with calls to a carrier's 800 or access code platform that involve, not just a through call to another party, but some independent information content given to the calling party by the carrier. Such calls ought to be treated as completed calls in their own right, even if there is no follow-up or completed call to a third party.

B. The Commission Should Adopt a "Carrier Pays" Mechanism on All Non-Sent Paid Calls

A number of carriers argue in favor of a "set use" fee on the theory that the payment burden should fall on the "cost-causative party" (i.e., the party making the call). See, e.g., Excel at 8; MCI at 6; Sprint at 12: Comments of One Call Communications at 4 ("Opticom"). But carrier-pays is just as effective at placing the burden on the cost-causative party. Since carriers are free to pass charges through to the caller (the cost-causer) on access code calls, they presumably will do so whenever it is efficient.[6] Indeed, carriers today pass through CCL charges to their customers as just another cost of doing business. Moreover, the Commission has correctly noted "that the carrier-pays mechanism is preferable because it would result in less transaction costs because the IXC could aggregate its payments to payphone providers." NPRM ¶ 28. Also, as AT&T points out, "[a] 'set use' payphone fee charged directly to end users through a coin-deposit approach would inconvenience callers and discourage payphone use, or even prevent such use altogether." AT&T at 12-13.[7]

PageNet argues that it is unfair to require 800 subscribers to pay per-call compensation on calls that they receive from payphones. PageNet at 3. It is the calling party, PageNet suggests, that is responsible for the call placement: the 800 subscriber agrees to toll free transport, not to the use of a payphone. But the 800 subscriber will not pay these charges

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[6]With respect to 800 subscriber calls, the cost-causer is the subscriber that invites the calls by having a toll-free number, not the caller who accepts the invitation. Consequently, carriers can pass these charges to the cost-causer (the subscriber) on 800 subscriber calls as well.

[7]PageNet points out that hotels and hospitals charge the calling party directly for the use of their CPE. Comments of PageNet at 9. But hotels and hospitals have an easy mechanism -- room charges -- to bill the calling party for use of the CPE on credit card and 800 calls (as well as for IX charges on 1+ calls); PSPs, in contrast, would have to require the deposit of coins. Hotels and hospitals also obtain commissions from IXCs on 0+ and revenue generating 00- calls.

directly; the charges will be absorbed by the carriers and reflected in general 800 subscriber rates. Part of what 800 subscribers buy is the ability for callers to reach them from payphones.

C. Tracking and Administration Should be the Responsibility of the Call's Primary Economic Beneficiary

A number of carriers argue that the tracking obligation for all calls should be placed on the LECs. See, e.g., Comments of the Cal. Ass'n of Long Distance Tel. Cos. at 4-5 ("CalTel"); MCI at 8. But this makes little economic sense, since it is the carriers (including LECs in their capacity as intraLATA toll carriers), not the LECs (in their capacity as access providers), that are the primary economic beneficiaries of these calls. NPRM ¶ 32. Indeed, the Commission has rejected a similar proposal once before, and there is no reason to think the idea has, like a fine wine, improved with age.[8]

In fact, there are significant limitations on a LEC's ability to track payphone calls made to an 800 or access code platform. See Sprint at 14 n.9. Once the call reaches a carrier platform, the LEC cannot determine whether a caller completed one call, or many calls, or no calls at all.[9] Thus, as Sprint acknowledges. IXCs and intraLATA toll carriers "are the only

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[8]See Second Report and Order, Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 7 FCC Rcd 3251, 3259 (1992). As the Commission explained, putting the burden on LECs requires them to track calls for their PSP competitors. Because LECs must be compensated for this function, the Commission would have to add to the CCL charge or institute a whole new billing and payment mechanism. Ibid. The more sensible approach is to put the burden of tracking a call on the party that derives the primary profit from it and has to track it in any event -- namely the toll carrier who bills the customer. Of course, some LECs may be able to offer tracking services for sale to carriers and PSPs, and may do so on a non-discriminatory basis. But there is no basis for requiring the LECs to perform this service for the benefit of other carriers and competing PSPs.

[9]The best the LEC can do is build in an algorithm based on duration to determine whether one or more completed calls has occurred. This provides, at best, a rough estimate and is likely to exclude many calls of short duration.

carriers that can track compensable calls." Id. at 2-3; accord Opticom at 7; Comments of the Ill. Pub. Telecom. Ass'n at 17-18.

Some carriers, however, claim that they too will have difficulty tracking at least some types of calls. For example, AT&T claims that it cannot "individually track 800 subscriber traffic (including debit card calls) to individual payphones" because "billing for toll-free calls is based upon the ANI of the terminating telephone, not the originating phone." Comments of AT&T at 14 (emphasis in original). AT&T estimates that "it would take over a year to develop and implement a system to track toll-free calls from payphones" and therefore suggests that PSP compensation on 800 calls be based on "a representative weighted sample of central-office-implemented payphones, from which autodialer fraud is less likely." Id. at 15.

It may well take IXCs some time to implement a proper tracking system for 800 calls (and the Coalition has already suggested permitting up to 12 months to have such systems in place). But AT&T has not proposed a fair interim method of tracking such calls. In those regions that use a mix of central-office-implemented (i.e., dumb) payphones and smart phones, the dumb phones tend to be placed in lower usage areas and therefore have much lower levels of 800 calls. Smart payphones are placed in high usage areas and have higher levels of 800 calls. The former are not a proper surrogate for the latter and would understate the number of 800 calls upon which per-call compensation must be paid.[10]

Concerns about possible auto-dialer fraud on 800 calls do not justify systematically undercounting such calls. And they certainly cannot justify excluding such calls altogether from

[10]One commenter suggests that special problems are posed for resellers, since they do not own the facilities and therefore cannot themselves conduct the tracking. Comments of Scherer Communications Group at 5. But resellers can purchase tracking from the underlying facilities-based carrier, which has tracking capability, or purchase it separately from an alternative source, such as a LEC that develops tracking.

per-call compensation. The way to deal with auto-dialer fraud is to adopt a regulation making it unlawful and impose strict penalties for violations Moreover, as CWI suggests (at 5-6), the Commission should permit carriers with evidence of such fraud to withhold payment pending investigation.[11]

CWI notes that IXCs will need to identify payphones by the "07" digit information, but "CWI is unsure of whether a payphone connected to a business line (rather than a COCOT line) would pass the 07 information digit on all originating calls." CWI at 11. CWI is correct on both counts. Payphone lines have a distinctive ANI. So if, as happens in some states, PSPs buy regular business lines from resellers rather than the tariffed COCOT service from LECs, those lines will not have distinctive payphone ANIs.[12] When this occurs, LECs cannot determine whether payphone CPE is being used on the line (preventing them from accurately compiling a list of payphone ANIs), and IXCs do not receive the distinctive ANIs that identifies calls as coming from a payphone. The obvious and only solution to this self-imposed "problem" is for PSPs to buy COCOT lines, not business lines. If you buy a cow instead of a horse, you can't complain when it doesn't ride to hounds.[13]

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[11]In addition, IXCs should be able to prevent most abuses by developing programs that detect call pumping by recognizing when a particular ANI goes over some threshold of usage. The combination of rules and network intelligence should deter or detect most types of call pumping.

[12]LECs currently provide quarterly reports on ANI and verification data to carriers. AT&T (at 17) provides no good reason to change this schedule to monthly reports, which would add significant expense. It should also be noted that, as CLECs and resellers proliferate, the obligation to provide this information should fall on whichever local provider has the billing relationship for dialtone with the PSP.

[13]If PSPs are concerned with the pricing of COCOT lines, that is an issue to be addressed in state regulatory proceedings. The critical point is that LEC PSPs will have to buy the same lines at the same price.

Some of the smaller carriers argue that it will be just too complex, too burdensome, and too expensive for them to implement a tracking system and issue reports. See, e.g., CWI at 10; Excel at 6. But such IXC complaints of burden and expense appear to be overblown. For example, AT&T -- which has by far the most complex task and the lion's share of calls to track -- apparently admitted in a California workshop that the cost of developing billing capacity would be less than $200,000. See Comments of The California Payphone Ass'n at 8 ("CPA"). This is not a significant expense when compared to the revenues garnered by the carriers. And if smaller carriers cannot afford to install their own tracking capacity, they can buy tracking from someone else. Those carriers that benefit from being in this market must accept the responsibilities that go with it, and tracking -- like other carrier obligations -- is one of those responsibilities.

D. The Per-Call Compensation on Toll Calls Should Provide "Fair" Compensation Based on Market Proxies

There is a consistent pattern among the comments on per-call compensation. Each carrier wants per-call compensation on a particular category of toll calls upon which it chiefly profits (whether it be debit card calls, or 800 calls, or access code calls) to be kept artificially low, with other categories of calls to make up the shortfall. Regulators, for the most part, want local rates kept low at the expense of toll rates. But the statute requires fair compensation on each and every call, not for some calls to subsidize others.

The American Public Communications Council ("APCC") asks the Commission to adopt "a uniform compensation rate applicable to all calls." APCC at i. But this too is the wrong approach. It would require the Commission to engage in endless proceedings and arguments over what constitutes the "fair" rate for all calls. As the Commission has pointed out, the market rate is inherently the fairest and the most efficient rate, and the market may well set different rates for different types of calls.

APCC claims that per-call compensation is too important to leave "to the vagaries of economic relations" (i.e., competition). Id. But this is the ultimate special interest plea: a guaranteed income, without risk. The Commission should let the market determine the proper rate of compensation where possible. And where the market cannot determine the rate, the Commission should use market proxies to set the rate, applying different rates for different call types if a free and unfettered market would do so as well. Competition is the most effective way for the Commission to cut through the special interest pleadings.

1. The Commission Should Use Market Proxies to Establish Default Compensation Levels for All Toll Calls, Including Access Code, Subscriber 800, Operator Service, and 1+ Calls

As explained in our opening comments, the Commission should use market proxies to set a default compensation level for all toll calls. By looking to 0+ commissions paid to independent PSPs, the Commission can determine an appropriate market-based rate. And by making it a default rate (rather than a mandated rate), the Commission can allow the parties to negotiate away from that rate where market forces would lead to a different result.

APCC argues that commission payments on 0+ calls are not compensatory because "those payments are for the value to the IXC of receiving presubscribed traffic from the location" and because they "do not address the need for compensation for use of the payphone." Id. at 20; see also Comments of Communications Central Inc. at 5-6. APCC is fundamentally mistaken regarding the economic relations between the PSP and the carrier. Fair compensation for use of the payphone on 0+ calls is nothing more nor less than what the presubscribed IXC is willing to pay for those calls in an arm's-length transaction, just as fair compensation for a frozen yogurt is precisely what consumers are willing to pay for the yogurt. The only logical way of calculating that value is to look to the marketplace. There are no platonic forms of fair prices.

ACTEL claims that the large number of dial-around calls has forced it to demand supracompetitive commissions on 0+ calls (which are now only 2.6% of calls from ACTEL payphones). Response of ACTEL, Inc. at 4-5 ("ACTEL"); see also APCC at 7 (interstate 0+ calls are being used as a source of subsidy for virtually all other categories of calls). This would suggest that 0+ rates are too high to use as a proxy. But, again, these commenters are ignoring simple economics. Where the market is working, supracompetitive pricing is impossible. Market-based prices are efficient prices; they cannot have a subsidy element built into them. It may be true that PSPs have had to rely disproportionately on 0+ commission revenues in light of the increasing number of dial-around and 800 subscriber calls. But that simply means that the disfunction caused by TOCSIA has required the latter to be given away for free when a competitive market would require payment. It does not mean that payments for the former have been, in any economic sense, "too high." Commissions on 0+ calls are the only good proxy for the Commission to rely upon in setting the default rate for per-call compensation on toll calls.

2. The Commission Should Not Set Per-Call Compensation on Toll Calls at Some Measure of "Cost"

Many of the carriers argue that costs -- particularly marginal costs -- should be the basis for determining per-call compensation. See, e.g., Excel at 2; Frontier at 6-7. Sprint goes so far as to suggest that PSPs should be reimbursed only for the "de minimis cost associated with the wear and tear of using the key pad and lifting the handset off the cradle." Sprint at 23. That is like arguing that a hotel should charge for rooms based on the de minimis cost of changing the sheets. As SPR explains, using marginal cost in an industry with high fixed costs is a "recipe for bankruptcy." Strategic Policy Research, Critique of Hatfield Cost Analysis at 3 (attached to the Reply Comments of BellSouth Corp.) ("SPR Reply"); see also APCC at 11. Marginal cost is thus an obviously inadequate measure of compensation. It would give carriers virtually a free ride, at the expense of PSPs

More fundamentally, any focus on costs, whether long run, short run or embedded, is simply the wrong approach. The statute does not employ any of the usual code words for rate of return regulation, such as a "reasonable" return on investment. It calls for "fair" compensation, and there is nothing fair about only recovering costs when buyers place a higher value on the product or service in question. Similarly, there is nothing fair about being guaranteed a full return on investment when the market indicates that the product or service is worth less. Sellers should be able to sell at market-based prices, nothing more, nothing less.

Focusing on costs would mean a giant step backwards for this industry, and would enmesh the Commission in numerous complicated, endlessly-disputed regulatory proceedings. What covers costs for one company will not cover them for another and will exceed them for a third. If the Commission concludes that "fairness" equals "cost recovery" then it will doom itself to separate cost proceedings for every PSP in the country. And, before that process even begins, it will have to resolve disputes over the relevant model to define cost recovery.

Certainly, the models proposed by AT&T and MCI are completely inadequate. AT&T argues for a TSLRIC methodology that totally ignores joint and common costs associated with the provision of payphone service. AT&T at 7. AT&T then compounds the problem by seeking to rely on the TSLRIC, not of any actual PSP, but of some hypothetical, ideally efficient PSP using the best and latest technology. AT&T at 10 & n.19. Technology is deployed over time, and no PSP will have only the latest and greatest technology; even if one did, it would be outdated tomorrow, long before any of the investment could be recouped. The Commission must recognize that actual PSPs -- not hypothetical ones -- will have to provide payphone service, and their actual costs, not some hypothetical costs, will have to be recouped if they are to stay in business.

AT&T also seeks to exclude two of the most important costs borne by PSPs: line costs and commissions paid to location providers. As Peoples notes: "The three most significant costs in providing payphone service are LEC line charges, premises owner commissions, and field service and collection costs -- the same costs that any PSP will face." Peoples at 21. There is no basis for excluding two of these legitimate costs, and AT&T's arguments in favor of exclusion are feeble. For example, AT&T argues that the Commission should not include "costs of the basic payphone line itself because that line will continue to be provided by the regulated LEC entity, and IXCs will continue to pay the LEC directly for their use of such lines through access charges." AT&T at 7. This makes no sense. Even if one assumes that the access charges paid by IXCs contribute to a reduction in the amount LECs charge all users for lines, the amount each PSP in fact does pay remains a legitimate and unavoidable cost of providing payphone service.

Similarly, AT&T suggests that "PSP commission costs paid to location owners should also be excluded from the TSLRIC analysis" because that will eliminate the need for regulators to decide what is a "reasonable commission" and reduce upward pressure on commissions that would result from a guaranteed recovery. Id. at 8. AT&T is wrong again. Commission payments are akin to rent paid to the location provider for the use of the location. If rental charges for the location are a legitimate expense, then so are commissions. Indeed, carriers like AT&T benefit from the location of a payphone just as much as PSPs do. It is the placement of a phone at that particular location that permits the carriers' customers to dial the revenue-producing calls in the first place. Nor are administrative difficulties in determining the reasonable level for this cost -- which AT&T overstates in any event[14] -- an adequate ground for

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[14]The market rate for commissions is by definition the proper price. If the price exceeded the value of the location, the PSP would refuse to pay it.

excluding those costs. If anything, they are a reason not to rely on costs at all, but on market-based proxies.

MCI relies on a study by Hatfield Associates, Inc., which purports to show a high-end cost estimate of 8.3 cents for access code calls (excluding 800 calls). This study is fundamentally flawed, both in conception and execution. As an initial matter, the Hatfield study focuses on the cost of installing and maintaining one additional payphone and then divides that amount by the average number of calls per payphone. But, under any plausible distribution of payphone usage, at least half of all payphones are used less than average. Thus, even if the Hatfield study calculated costs correctly (and, as we shall see, it does not), half of all payphones would receive compensation less than their costs. Since nothing in the statute requires PSPs to subsidize unprofitable phones with profitable ones, the Hatfield model would lead to the immediate removal of more than half of all payphones. See SPR Reply at 9.

Moreover, as NYNEX demonstrated when MCI first introduced it, see NYNEX Reply Comments, CC Dkt. No. 91-35 (FCC Oct. 31, 1995), the Hatfield study very selectively incorporates data from a 1993 New England Telephone Payphone cost study. See also C. Geppert, Critique of MCI's Use of the Hatfield Study and Other Issues (attached hereto as Exhibit A). The New England Telephone study examined the costs of providing indoor and outdoor coinless and coin payphone service as well as coin semi-public service in New Hampshire. In developing its per-call cost of $.083, however, MCI only used the data on the cost of providing coinless phones indoors. This cost was $300.39. Indoor coinless payphones, however, represent only 5.9% of the entire New Hampshire payphone base. Taking outdoor payphones into account, the average cost for all payphones goes up to $590.52, nearly twice the cost utilized by MCI. Even this figure would have to be adjusted upwards since the average cost of providing a payphone is now in excess of $1,000.

To compound matters, the Hatfield study shows maintenance costs of $38.18 per phone. Again, this is the cost for maintaining indoor coinless payphones. For all payphones in New Hampshire, the maintenance cost was $166.05 per phone in 1993. Even this higher figure is still much too low, however, because maintenance and vandalism costs on payphones in urban areas, like New York, are much higher than in rural areas like New Hampshire, and there are many more phones in urban than in rural areas.

The Hatfield study commits an even more egregious error when it excludes costs associated with coin phones from the numerator of its per-call equation, while including coin calls themselves in the denominator. In other words it spreads the cost of coinless phones over all calls, including coin calls. This is flatly dishonest. The Hatfield study also does not include the costs of commission payments, and uses 1993 data without adjusting for inflation. Furthermore, while the study uses New Hampshire data in certain instances, it utilizes national data in other instances. For example, the study uses $320 per year as the cost of a business line. In New Hampshire, the cost is $525 per year. If that data had been used, the resulting cost per call would obviously have been higher. Still other costs, such as new line costs, must be included to develop any per-call compensation in this proceeding. Correcting for these errors would lead to a per call cost of $.306. See Exhibit A at 3.[15]

[15]MCI alternatively tries to rely on a 1991 Commission suggestion that 12 cents per call might cover PSP costs. MCI at 13. But the Commission emphasized that this figure was only an "example," and that it was "not proposing" the figure as an appropriate rate. Report and Order and Notice of Proposed Rulemaking, Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 6 FCC Rcd 4736, 4747-48 (1991). Moreover, that figure was derived in part from local payphone charges, which are regulated, are not based on costs, and in fact do not recover costs. See id. at 4747. This figure also excludes costs for the business line and coin collection, which are both legitimately incurred. Equally improper is Sprint's suggestion that "the proper unit charge would be 6.75 cents per call" (which Sprint derives by noting that PSPs currently get $.25 per call on access code calls from AT&T and Sprint and that these are only 27% of the total calls) Sprint at 23. These numbers have nothing to do with costs and

3. Local Coin Rates Are Not a Good Surrogate for Per-Call Compensation on Toll Calls

Opticom "supports the use of a flat rate approximating the local rate for fair compensation for PSPs." Opticom at 8. But, as explained in our opening comments, local rates in many areas are held artificially low by regulators. They bear no relationship even to cost, much less to the market-based proxies that should guide the Commission's judgment. Market forces would in fact lead to very different rates for per-call compensation on local and toll calls.

It is true that "[f]ailure to ensure fair compensation for any particular group of calls would be a legal error" (APCC at 10), but that doesn't mean that all call groups require the same methodology to determine fair compensation. AT&T suggests that "[a] payphone performs identical services in connection with every call, regardless of the type of call or where it terminates." AT&T at 10. It may be true that costs do not differ significantly, but market-based pricing still predicts price differences due to varying demand and other factors.

APCC argues that determining the rate for each class of calls "(perhaps on a jurisdiction-by-jurisdiction basis) to determine whether existing compensation levels are 'fair' before a given class or subclass of calls may be included in the prescribed compensation . . . would be needlessly complicated." APCC at 10. But the complications disappear if market forces are allowed to work wherever they can, as with local calls, or if market-based proxies are used on calls (such as dial-around and 800 subscriber) that are comparable to calls (0+ presubscribed calls) where the market sets a rate.

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even less to do with fair compensation. They rely on the fact -- which the Act is meant to change -- that a high portion of calls are not compensated today.

E. Compensation on Local Coin Calls Must Be Fair and Fully Compensatory

As the Coalition explained in its opening comments, three of its members support immediate deregulation of local payphone rates Nothing in the comments filed to date indicates that the market is insufficiently competitive to let market forces determine the rate. Quite the opposite: The Iowa Utilities Board points out (at 3) that deregulation has worked well in that state and "urges the FCC to set rules that will not force states such as Iowa to re-regulate services that are competitive and have been deregulated." Nonetheless, other members of the Coalition urged the Commission to allow those states that still regulate local call rates to continue to do so, subject to an FCC methodology and oversight, during a transitional period.

Among the state regulators filing comments, most do not want to be preempted on the local coin rate, but appear willing to accept "a 'per-call' pricing methodology for determining fair compensation for PPOs generally." Comments of the State of California and the California Public Utilities Commission at 13 ("CalPUC"). See also Comments of the New York City Dep't of Info. Tech. and Telecomm. at 9; Comments of the New York State Dep't of Pub. Serv. at 3 ("NYPDS"). The problem with this approach is three-fold. First, it could take a long time for states to implement the "per-call" methodology, causing the statutory command of fair compensation to go unheeded for years on end. Consequently, if the Commission requires the states to follow an FCC formula, it must set a firm deadline for state implementation. See Coalition Comments at 22-23 (suggesting 90 days from effective date of Commission order). Second, and more fundamentally, local regulators have little if any incentive to ensure that rates reach their natural market level. The methodology therefore must take into account all relevant costs and a reasonable profit margin. Id. Third, and finally, it makes no sense to remove assets from the rate base (as required by the statute) and then continue rate-of-return proceedings on those assets. This simply invites local regulators to support local calls by prescribing rates that are too low, and saddles the FCC with cumbersome review duties. Accordingly, the FCC must sunset state regulation at a definite point in time so that competitive forces, rather than cumbersome regulatory intervention, can establish prices in this competitive marketplace. Id. at 22.

In the end, ensuring that the local coin rate is adjusted to competitive levels will best serve the public interest and the Commission's statutory mandate. As APCC (at 14) explains, the local coin rate in most states has not increased significantly in more than a decade. Because these rates are artificially low, local coin calls produce a relatively small proportion of total payphone-originate revenue. Separate Statement of Chairman Hundt at 1. "But the mere fact that local coin revenue is low is not a good reason for keeping it low." APCC at 15.

Artificially low coin rates are not only contrary to the statute but counterproductive as well. Puerto Rico Telephone Company (at 2) makes an emotionally powerful case for a $.10 rate based on the need for payphones to serve low income communities with low residential service penetration. But such phones can only be maintained in a monopoly provider environment with heavy subsidies, something inconsistent with Section 276. And even though "[t]he purpose of this 10 cent limitation is noble -- to insure that inexpensive coin calling is provided to those who are economically less fortunate [--] the effect is exactly the opposite. Many people in low income areas rely exclusively upon payphones for their access to the telecommunications network. The 10 cent local coin rate either considerably decreases or eliminates the economic incentive to provide any payphone service to these areas. This depressed economic incentive causes locations that need payphone service the most to be severely under served." Comments of the South Carolina Public Communications Ass'n at 4 ("South Carolina PCA").